Arizona State Senate
Issue Paper

November 16, 2006

Note to Reader:

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HIGHWAY FUNDING AND CONSTRUCTION

INTRODUCTION

Congestion and mobility are key issues facing Arizona. How to solve gridlock with a growing population and a high ratio of personal vehicle use is a crucial question facing state policymakers. Congestion relief measures undergo intense scrutiny and are influenced by lobbying efforts from environmental groups and industry. Transportation philosophies and growth management styles differ; however, one constant is that sustained funding is necessary for transportation projects of all kinds to proceed.

According to the National Conference of State Legislature's (NCSL) Surface Transportation Funding report, historically, states have funded transportation projects by paying for construction, maintenance and administration as money becomes available from user fees and federal grants. NCSL further asserts that, increasingly, states with rapid growth are finding that existing revenues may not be enough. In many states, legislatures cannot solve transportation problems because they cannot afford to do so. Rapid growth has also increased public demand for transportation services, strained existing infrastructure and drained financial resources. To pay for projects, states more frequently are turning to bonds and newer financing methods to meet transportation needs.

HIGHWAY USER REVENUES

States are responsible for approximately 75 percent of the total capital expenditures for highway and mass transit programs, with the remaining 25 percent derived from local and federal sources. The majority of state transportation funding comes from highway user revenues.

The Arizona Highway User Revenue Fund (HURF), established in 1974 and administered by the Arizona Department of Transportation (ADOT), is the depository fund for motor fuel tax revenues and revenue collected from a variety of fees and charges relative to the registration and operation of motor vehicles on Arizona's public roadways.

Article IX, Section 14 of the Arizona Constitution requires monies derived from fees, excises or taxes relating to motor vehicles or fuels to be expended for highway and street purposes.

This requirement applies to all HURF revenues except vehicle license tax (VLT) monies. The following fees and taxes are the primary source of HURF revenue:

Gasoline taxes are the taxes paid at the pump when purchasing gasoline for cars and trucks. Arizona's motor vehicle fuel tax rate is 18 cents per gallon, which has been the rate since 1990. The gas tax is the primary source of revenue for HURF.

Use fuel tax refers to taxes on diesel fuel. Since January 1, 1998, the tax for diesel passenger cars and light trucks is 26 cents per gallon for most large commercial diesel trucks and buses. Diesel vehicles used for government, nonprofit or religious purposes pay 18 cents per gallon. Additionally, from September 1, 2005, to December 31, 2010, vehicles used to transport forest products may pay a reduced use fuel tax of 13 cents per gallon.

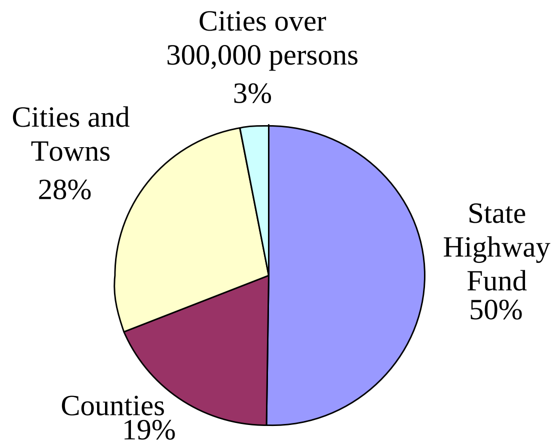
A **motor carrier tax** was first introduced in Arizona in 1979 as a motor carrier use tax. It has undergone several changes in recent years. Currently, motor carrier fees are based strictly on the weight of the vehicle and generate the least amount of HURF revenue. The motor carrier use tax is paid by interstate commercial carriers.

The **VLT** is an in-lieu property tax originally approved by the voters in 1940. It is the only inflation-response HURF revenue source. The amount due is dependent on the value of the vehicle. In recent years, the VLT rate has been reduced by the Legislature.

Registration fees are composed of county registration, noncommercial and commercial vehicle registration and commercial weight fees; apportioned registration and commercial registration fees allocated according to miles traveled in Arizona; and miscellaneous registration, nonresident permits, unassigned registration, prorate stickers and registration penalties.

HURF Distribution

Statute requires $1 million in HURF monies to be transferred to the Economic Strength Project Fund and up to $10 million to be transferred to the Department of Public Safety (DPS) for highway patrol expenditures. These statutory transfers, as well as any legislative appropriations from HURF, are completed prior to the distribution to local governments and the State Highway Fund. The distribution of *remaining* HURF monies is as follows:



Counties with a population of over 400,000, and cities with a population of over 30,000 that are located within those counties, are required to maintain a certain level of expenditures of local revenue for street and highway purposes. This requirement is known as "maintenance of effort" and requires these local entities to expend local revenue at a level computed as an average of local funds expended in any four of the five fiscal years between FY 1981-1982 and FY 1985-1986. Local revenue does not include state or federal grants, interest income, bond proceeds, HURF monies, Local Transportation Assistance Fund monies or funds specifically collected for debt service.

Cities and counties required to comply with maintenance of effort statutes must certify their compliance to ADOT by December 31 of each year. Failure to comply with or annually certify maintenance of effort results in a reduction of HURF distribution to that city or county. In 2002, the Legislature enacted an emergency measure that suspended the maintenance of effort requirements for three years. Maintenance of effort requirements became effective again on July 1, 2005.

BONDS

Bonds are a common mechanism that states use to borrow money for transportation projects. An investor buys a bond on a promise that, on a specified maturity date, the issuing entity will repay the full principal amount. The issuing entity also pays the investor a specified rate of interest for the bond. Bonds can be issued by public authorities or sold by private entities and come in a variety of different forms.

Municipal and Public Bonds – Bonds issued by state and local governments to finance transportation projects or other public works are known as municipal or public bonds. Interest income from public bonds is exempt from federal income taxes and often exempted from taxation by state and local governments. State and local governments issue several types of bonds. Examples include county and city street and highway improvement bonds.

Anticipation Notes – Anticipation notes are public securities issued when money is expected from a specific source. States can issue anticipation notes that can be paid off with future bond issues (bond anticipation notes–BANs) or through future tax revenue (tax anticipation notes–TANs). States also can use two federal tools – grant anticipation revenue vehicles (GARVEES) and transit grant anticipation notes (GANS) – to issue bonds for highway and transit projects that can be repaid with future aid grants from the federal government. Arizona has adopted a program allowing local communities to issue anticipation notes for transportation projects that are repayable with funds established by the Arizona Regional Area Road Fund (RARF) law. The state RARF statute created special funds for transportation projects that were supported with transportation excise taxes. Statute allows local counties to issue bonds that are payable solely with excise tax money that is accumulated in the RARF. Proposition 400, approved by Maricopa County voters in November 2004 to add additional freeways and expand and improve existing freeways and roads, is an example.

Revenue Bonds – Revenue bonds are public bonds issued to finance projects that generate revenue, such as toll roads or bridges or fares collected from transit projects. The revenue from the project is used to make principal and interest payments to bond holders. In Arizona, the State Transportation Board has the exclusive authority to issue revenue bonds for financing needed transportation improvements throughout the state. Revenue bonds have been issued in Arizona for highway construction, which are funded primarily through gasoline taxes.

Limited and Special Tax Bonds – Limited and special tax bonds are paid through proceeds from a special tax. Unlike a general obligation bond, where a state or local government can raise taxes indefinitely to repay the loan, limited or special tax bonds are tied to a particular tax levied for an express purpose. Often, voter approval may be required for the tax.

Private Activity Bonds – To provide the opportunity for new sources of investment capital to finance the U.S. transportation infrastructure system, the federal Safe, Accountable, Flexible, Efficient Transportation Equity Act: A Legacy for Users (SAFETEA – LU) expanded bonding authority for private activity bonds by adding highway facilities and surface freight transfer facilities to the list of activities eligible for tax-exempt facility bonds. These bonds are not subject to the general annual volume cap for private activity bonds for state agencies and other issuers but are subject to a separate national cap of $15 billion.

In Arizona, the issuer of private activity bonds is generally an industrial development authority (IDA), which is sponsored by a county, city or town. Eligible transportation projects include airports, mass commuting facilities, parking facilities and public transportation infrastructure.

ALTERNATIVE FUNDING STRATEGIES

Public-Private Partnerships

Legislatures are turning to the private sector for assistance in improving efficiency and meeting the financial demands of maintaining and improving transportation systems. Transportation facilities represent an area where the private sector is willing to invest in projects in a variety of capacities. As many as 23 states, including Arizona, have statutes that enable the use of various transportation funding approaches involving private entities.

Advantages cited by the Federal Highway Administration (FHWA) include cost savings, cost predictability, reduced project completion time and greater private sector investment. By definition, public-private partnerships (PPPs) give to private entities varying degrees of responsibility for project management and completion. FHWA has estimated that PPPs can save as much 6 percent to 40 percent of the cost of construction and limit the potential for cost overruns.

According to NCSL, concerns about private involvement in transportation projects often include the following:

- Existing or interpreted legal prohibitions, regulatory restrictions or procedural restrictions that amount to a lack of authority to engage in PPPs.
- Institutional inertia or opposition by parties that fear change to traditional project delivery approaches.
- Lack of dedicated revenues or innovative financing mechanisms to support projects.
- A lack of familiarity with the PPP process and allocation of risk.

State Infrastructure Banks

State infrastructure banks (SIBs) are state or multistate revolving loan funds that provide loans, credit assistance and enhancements, and other financial assistance for surface transportation projects. SIBs are established with initial seed capital from and are administered by states. Revenue from borrowers goes back to the SIB to help fund future projects.

In 2005, SAFETEA-LU established a new SIB program that allows all states, American Samoa, the Commonwealth of the Northern Mariana Islands, the District of Columbia, Guam, Puerto Rico and the Virgin Islands to capitalize SIBs with federal transportation funds authorized for federal FYs 2005-2009 using an 80-20 federal to non-federal funds match. The new law allows states to establish three different SIB accounts for highway, transit and rail projects and allows SIBs to provide loans and credit enhancement to both public and private entities for authorized projects.

Using the federal SIB laws, Arizona established the Highway Expansion and Extension Loan Program (HELP), which is a comprehensive loan and financial assistance program for eligible highway projects in Arizona. The HELP provides the state and communities in Arizona a financing mechanism to accelerate transportation construction projects. From FY 1998-1999 to FY 2006-2007, the HELP has provided approximately $600 million in loans to accelerate highway construction projects.

Congestion Pricing

This option charges motorists tolls for using congested roads during peak driving hours. Congestion pricing has more frequently been used as a behavior modification tool rather than a fundraising mechanism. There are concerns that congestion pricing could not generate sufficient funding to meet primary transportation funding needs.

Since February 2003, London, England, has charged a fee for driving private vehicles in the city’s central area during weekdays as a traffic reduction and revenue generating mechanism. According to a Victoria Transport Policy Institute analysis, the policy has reduced traffic congestion, improved bus and taxi service and generated revenue. Since London’s congestion pricing policy adoption, cities such as Singapore, Toronto and San Diego have implemented various manifestations of the strategy.

Facility Tolling

This option charges a toll user fee for a motorist’s use of a transportation facility such as a limited access roadway or bridge. Collection of the toll can occur through toll booths, electronic tolling or other means. Toll rates vary depending on the purpose of the toll, and electronic tolling can eliminate congestion caused by traditional toll booths.

Public pressure, however, can make tolling politically difficult. Frequently cited criticisms include: some motorists and truck drivers are unfairly burdened by tolls; the public should not be forced to pay for a road that is already built; they disproportionately affect low-income motorists who can less afford to pay; and some view tolls as double taxation because motorists already pay motor fuel taxes.

High occupancy tolls (HOT), used in California, Colorado and Virginia, allow single occupants of vehicles to access high occupancy vehicle facilities by paying a toll. HOT lanes have the ability to shift traffic from free congested lanes to less congested tolled high-occupancy lanes. Currently, Arizona law only allows private tolls. Installing HOT lanes on an interstate or other public thoroughfare would require a statutory change and possibly the permission from the federal government if the project used federal funds.

Privatizing Transportation Facilities

In 2005, Chicago completed a $1.83 billion transaction to sell the rights to operate the Chicago Skyway – a 7.8-mile, six-lane toll bridge – to a private company. Since then, lawmakers and transportation officials in at least 13 states have taken steps to evaluate proposals or legislation to privatize public transportation facilities.

ADDITIONAL RESOURCES

- Arizona Constitution, Article IX, Section 14
- HURF Statutes: Arizona Revised Statutes, Title 28, Chapter 18
- HELP Statutes: Arizona Revised Statutes, Title 28, Chapter 21, Article 5
- Arizona Department of Transportation
  602-712-7227
  www.azdot.gov
- FWHA Public-Private Partnerships
  www.fhwa.dot.gov/ppp
- National Conference of State Legislatures Report: Surface Transportation Funding - Options for States
  www.ncsl.org/programs/pubs/summaries/014233-sum.htm
- Congressional Budget Office – Congestion Pricing for Highways
  www.cbo.gov/showdoc.cfm?index=4197&sequence=0